(Decision No. 91379)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

RE: INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFF -- COLORADO PUC NO. 5 - TELEPHONE, MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, DENVER, COLORADO.	)	INVESTIGATION AND SUSPENSION DOCKET NO. 1108 PHASES I AND II DECISION AND ORDER OF THE COMMISSION

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September 30, 1977
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Appearances: Coleman M. Connolly, Esq., and Peter D. Willis, Esq., Denver, Colorado, for Mountain States Telephone and Telegraph Company, Respondent;

D. Bruce Coles, Esq., Denver, Colorado, for Mountain Plains Congress of Senior Organizations;

John L. Mathews, Western Area Chief Counsel, Regulatory Law, General Services Administration, San Francisco, California, for the Executive Agencies of the United States;

Messrs. Gorsuch, Kirgis, Campbell, Walker & Grover, by Leonard M. Campbell, Esq., Clinton P. Swift, Esq., and Gary Cohen, Esq., Denver, Colorado, for Colorado Municipal League and AMAX, Inc.;

Messrs. Rothgerber, Appel & Powers, by James M. Lyons, Esq., and Gregory Kanan, Esq., Denver, Colorado, for United Business Systems;

Messrs. Welborn, Dufford, Cook & Brown, by Richard L. Fanyo, Esq., Denver, Colorado, for CF&I Steel Corporation;

Tucker K. Trautman, Esq., and Eugene C. Cavaliere, Esq., Assistant Attorneys General, Denver, Colorado, for the Commission.

BY THE COMMISSION:

STATEMENT

I

HISTORY OF PROCEEDINGS

On February 25, 1977, Mountain States Telephone and Telegraph Company (hereinafter referred to as "Mountain Bell," "Company," or "Respondent") filed Advice Letter No. 1279 and tariff revisions that would have resulted in increased rates on most of the Company's Colorado intrastate telecommunications services. According to Advice Letter No. 1279, the effect of the revisions would be to produce additional gross revenues of not more than $50,240,000 when applied to Mountain Bell's Colorado intrastate service volumes actually experienced for the calendar year 1976.

On March 15, 1977, by Decision No. 90330, the Commission set the tariffs filed with Advice Letter No. 1279 for hearing. Pursuant to the provisions of C.R.S. 1973, 40-6-111(1), the effective date of the tariffs filed with Advice Letter No. 1279 was suspended by operation of law for a period of 120 days. Also by Decision No. 90330, the Commission further suspended the tariffs filed with Advice Letter No. 1279 for an additional 90 days, for a total of 210 days, i.e., until October 24, 1977. Also, by Decision No. 90330, the Commission provided that any person, firm or corporation desiring to intervene as a party in this Investigation and Suspension Docket No. 1108 (hereinafter referred to as "I&S Docket No. 1108") was to file with the Commission on or before April 15, 1977, a petition for leave to intervene.

On April 13, 1977, the Commission entered Decision No. 90504. In Decision No. 90504, the Commission stated that it would hear I&S Docket No. 1108 in two phases, as it had done in Investigation and Suspension Docket No. 930. Phase I would be limited solely to issues relating to determining the revenue requirement for Mountain Bell's Colorado intrastate services and Phase II limited solely to issues

relating to spread of the rates. The Commission also stated that, as in prior general rate increase filings of Mountain Bell, it would determine Mountain Bell's revenue requirement on the basis of a past test year, adjusted for in-period and out-of-period expenses and revenues. The Commission found that the calendar year 1976 would be a proper test year in this proceeding, and directed that all testimony filed in Phase I should be based upon the calendar year 1976 as the proper test period. The Commission in Decision No. 90504 stated that it would also utilize the procedure adopted in I&S Docket No. 930 by requiring that all direct testimony of Respondent, Intervenors and Staff of the Commission be in writing in question-and-answer format, with hearing time limited solely to cross-examination of witnesses who had filed written direct testimony. In Decision No. 90504, the Commission stated that it would enter a brief interim decision following completion of Phase I hearing; that the interim decision would establish, without elaboration or explanation, and for purposes of Phase II spread-of-the-rates testimony, the revenue requirement for Mountain Bell's Colorado intrastate telephone business and the dollar amount of any gross revenue increase or decrease. The Commission then concluded Decision No. 90504 by setting forth the procedural dates to be utilized in I&S Docket No. 1108. It was provided in Decision No. 90504 that on or before May 13, 1977, Mountain Bell was to file its written direct testimony and exhibits in its direct case in Phase I and that on June 6 (commencing at 2 p.m.), 7, 8 and 9, 1977, said witnesses of Mountain Bell would be produced for purposes of cross-examination. It was provided further in Decision No. 90504 that on or before July 8, 1977, Intervenors and Staff of the Commission were to file their written direct testimony and exhibits in Phase I and that on July 25 (commencing at 2 p.m.), 26, 27 and 28, said witnesses would be produced for purposes of cross-examination. The date of July 29, 1977, was set in Decision No. 90504 for the rebuttal case of Mountain Bell. It was further stated in Decision No. 90504 that the Commission would enter

an interim decision, referred to above, on August 5, 1977. The Commission further provided that on or before August 12, 1977, Mountain Bell was to file its written direct testimony in Phase II, that on or before August 19, 1977, Intervenors and Staff of the Commission were to file their written direct testimony in Phase II and that on dates of August 23 and 24, 1977, all witnesses who had filed written direct testimony in Phase II would be produced for cross-examination. The Commission concluded the statement portion of Decision No. 90504 by stating that it would conduct hearings for the purpose of receiving statements and testimony from public witnesses on the dates of May 23 in Lamar, May 24 in Pueblo, May 25 in Durango, May 26 in Grand Junction, May 27 in Glenwood Springs, and July 12 and 13, 1977, in Denver, Colorado.

In response to Decision No. 90504, Mountain Bell filed its direct case in Phase I on May 13, 1977, by filing the written direct testimony of Lloyd L. Leger, William J. Horton, Wayland H. Lanning, Mark E. Notestine, William F. Neathammer, J. Michael Landau, Roger L. McLaughlin, James T. Gibbons, Frank L. Schmitt, Kenneth L. Schneider, Ezra Solomon, William T. Danner, John W. Kendrick, and Norman W. Leake. On the dates of June 6, 7, 8, 9, 22, 23, 29 and 30, 1977, cross-examination was heard by the Commission of all of the above witnesses.

Also, in response to Decision No. 90504, Intervenors Colorado Municipal League and AMAX, Inc., filed on July 8, 1977, in Phase I written direct testimony of David A. Kosh and Richard D. Gardner. Also, on July 8, 1977, Staff of the Commission filed written direct testimony of James D. Grundy, Craig Merrell and James A. Richards. On July 18, 1977, Intervenor General Services Administration, after leave was granted to late file testimony, filed written direct testimony of Mark Langsam. On the dates of July 25, 26 and 27, 1977, the Commission heard cross-examination of the above witnesses for Intervenors Colorado Municipal League and AMAX, Inc., General Services Administration, and Staff of the Commission.

On July 28 and 29, 1977, Mountain Bell called as witnesses in its rebuttal case, Emre T. Altman, Roger T. Fuller, Ted J. Fiflis, George D. Christy and Norman W. Leake. The direct, cross-, redirect and recross-examinations of said witnesses were conducted wholly oral.

On August 5, 1977, the Commission entered as an interim decision, Decision No. 91106 in which it established the revenue requirement of Mountain Bell's Colorado intrastate telephone business, on the basis of test-year 1976 conditions. The Commission found in Decision No. 91106 that an increase in revenue in the amount of $4,558,000 was required to offset a $2,136,000 net operating earnings deficiency. The finding of a net operating earnings deficiency of $2,136,000 was exclusive of any expenses relating to the 1977 wage and benefit out-of-period adjustment proposed by Mountain Bell in Phase I, which was subject to adjustment in the event the Bell System signed a new contract prior to September 20, 1977, with the labor union representing craft employees.

In compliance with Decision No. 90504, on August 12, 1977, Mountain Bell filed in Phase II the written direct testimony of Roger T. Fuller and Glenn H. Brown; on August 16, 1977, Colorado Municipal League filed the written direct testimony of Ross Benson; and the Staff of the Commission filed written direct testimony of George J. Parkins. On August 23, 1977, the Commission heard cross-examination of all witnesses who had filed testimony in Phase II of this proceeding. Mountain Bell called one witness, Roger T. Fuller, in its rebuttal case during Phase II. Direct, cross-, redirect and recross-examinations of Mr. Fuller were held orally on August 23, 1977.

II

PARTIES

On March 16, 1977, the City and County of Denver by its City Attorney, Max P. Zall, and Assistant City Attorneys, Brian H. Goral and Godfrey S. Wasson, filed a Motion to Intervene and Protest in this proceeding. On March 22, 1977, by Decision No. 90368, the Commission granted leave to intervene to the City and County of Denver.

On March 17, 1977, the Regents of the University of Colorado, by its attorney, George D. Dikeou, Assistant Attorney General, filed a Motion to Protest and Intervene. On March 22, 1977, by Decision No. 90352, the Commission granted leave to intervene to the Regents of the University of Colorado.

On March 30, 1977, CF&I Steel Corporation, by its attorneys, Welborn, Dufford, Cook & Brown, David W. Furgason and Richard L. Fanyo for the firm, filed a Petition to Intervene. On April 5, 1977, by Decision No. 90442, the Commission granted leave to intervene to CF&I Steel Corporation.

On April 6, 1977, the Colorado Municipal League and AMAX, Inc., by their attorneys Gorsuch, Kirgis, Campbell, Walker & Grover, Leonard M. Campbell, William Hamilton McEwan, and Gary S. Cohen for the firm, each filed a Petition to Intervene. Also, on April 6, 1977, United Business Systems, Inc., by its attorneys Rothgerber, Appel & Powers, James M. Lyons for the firm, filed a Petition to Intervene. On April 12, 1977, by Decision No. 90475, the Commission granted leave to intervene to the Colorado Municipal League, AMAX, Inc., and United Business Systems, Inc.

On April 15, 1977, Nolan Brown, District Attorney for the 1st Judicial District; Alex Hunter, District Attorney for the 20th Judicial District; and Dale Tooley, District Attorney for the 2nd Judicial District, filed a Petition to Intervene on their own behalves and on behalf of the residents of their respective districts. Also, on April 15, 1977, Mountain Plains Congress of Senior Organizations, by its attorney, D. Bruce Coles, filed a Petition to Intervene. Also, on April 15, 1977, J. C. Penney Co., Inc., by its local attorney, John P. Thompson, filed a Petition for Leave to Intervene. On April 26, 1977, by Decision No. 90566, the Commission granted leave to intervene to the District Attorneys of the 1st, 2nd and 20th Judicial Districts of the State of Colorado, Mountain Plains Congress of Senior Organizations, and J. C. Penney Co., Inc.

On April 18, 1977, the General Services Administration, acting on behalf of the Executive Agencies of the United States Government, Herman W. Barth, Acting General Counsel; Spence W. Perry, Assistant General Counsel, Regulatory Law Division; William Page Montgomery, Attorney; and John L. Mathews, Western Regional Attorney, late filed a Petition of the General Services Administration for Leave to Intervene. On April 26, 1977, by Decision No. 90548, the Commission granted leave to intervene to General Services Administration.

On April 25, 1977, the Communications Workers of America, AFL-CIO, by its CWA Representative William H. Thornburg, late filed a Petition to Intervene. On May 3, 1977, by Decision No. 90585, the Commission granted leave to intervene to the Communications Workers of America, AFL-CIO.

On May 12, 1977, Paul Beacom, District Attorney for the 17th Judicial District, by his attorney, Richard Wood, late filed a Petition to Intervene. On May 17, 1977, by Decision No. 90674, the Commission granted leave to intervene to the District Attorney for the 17th Judicial District.

III

TESTIMONY AND EXHIBITS

The Commission in this rate proceeding has utilized certain procedural methods designed to reduce hearing time and afford parties testimony and exhibits in advance of cross-examination.

First of all, the Commission in this proceeding has required that all testimony filed in the direct case of the participating parties be in writing and pre-filed in advance of cross-examination. All hearing time, except for Respondent's rebuttal case in Phase I and Phase II, has been reserved solely for cross-examination of witnesses filing written testimony. All pre-filed written testimony has been marked as an exhibit, offered and received into evidence instead of being orally

read into the record. In addition, the Commission has separated this rate proceeding into two phases, i.e., Phase I to determine the Company's revenue requirement; and, Phase II to determine the spread of the rates.

In this proceeding, all pre-filed written direct testimony has been marked as exhibits using letters of the alphabet. All exhibits filed with and in support of written direct testimony or which were offered during cross-examination have been marked using Arabic numerals. The following is a list of all pre-filed written direct testimony in Phase I and Phase II of this proceeding which has been marked and received into evidence:

Exhibit	Title and Description
	Phase I
A	Testimony of Lloyd L. Leger
B	Testimony of William J. Horton
C	Testimony of Wayland H. Lanning
D	Testimony of Mark E. Notestine
E	Testimony of William F. Neathammer
F	Testimony of J. Michael Landau
G	Testimony of Roger L. McLaughlin
H	Testimony of James T. Gibbons
I	Testimony of Frank L. Schmitt
J	Testimony of Kenneth L. Schneider
K	Testimony of Ezra Solomon
L	Testimony of William T. Danner
M	Testimony of John W. Kendrick
N	Testimony of Norman W. Leake
O	Testimony of David A. Kosh
P	Testimony of Mark Langsam
Q	Testimony of Richard D. Gardner
R	Testimony of James D. Grundy

Exhibit	Title and Description
S	Testimony of Craig Merrell
T	Testimony of James A. Richards
	PHASE II
U	Testimony of Roger T. Fuller
V	Testimony of Ross Benson
W	Testimony of Glenn H. Brown
X	Testimony of George J. Parkins
Y	Testimony of Norman W. Leake
Z	Testimony of B. Floyd Bennett, Jr.

Eighty-eight exhibits were offered with and in support of pre-filed written testimony or during cross-examination and were marked using Arabic numerals. Exhibit No. 86 was sealed upon stipulation of the parties. The following is a list of said exhibits:

Exhibit No.	Title or Description
	PHASE I
1	Exhibit to testimony of Lloyd L. Leger
2	Exhibit to testimony of William J. Horton
3	Exhibit to testimony of Wayland H. Lanning
4	Exhibit to testimony of Mark E. Notestine
5	Exhibit to testimony of William F. Neathammer
6	Exhibit to testimony of J. Michael Landau
7	Exhibit to testimony of Roger L. McLaughlin
8	Exhibit to testimony of James T. Gibbons
9	Exhibit to testimony of Frank L. Schmitt
10	Exhibit to testimony of Kenneth L. Schneider
11	Exhibit to testimony of Ezra Solomon
12	Exhibit to testimony of William T. Danner
13	Exhibit to testimony of John W. Kendrick

Exhibit No.	Title or Description
14	Exhibit to testimony of Norman W. Leake
15	Mountain Bell's Stock Must Sell Above Book Value to Insure Financial Integrity
16	Mountain Bell Market Price Per Share
17	Mountain Bell's Stock Must Sell Above Book Value to Insure Financial Integrity
18	Public Utility Bond Yields Remain Near Historic Highs
19	Aaa Public Utility New Issue Bond Yields, 1968-1976
20	Public Utility Bond Yields Remain Near Historic Highs
21	Economic Forecasts for 1977
22	Article from August 26, 1977, Wall Street Journal, entitled "Telephone Issues Stop Getting Busy Signals as Investors Fear Inflation and Interest Rates"
23	Spread in Return; Stock vs. Bonds for Various Periods (Ibbotson-Sinquefield Study)
24	Response to Question in Transcript, Colorado Public Utilities Commission I&S Docket No. 1108, J. T. Gibbons, page 218, June 8, 1977
25	Conclusions - License Contract Steering Committee
26	List constituting specific ways in which billing to the license contract may be decreased or total expenditures reduced
27	Alternatives to Funding, General Department and Bell Laboratory Activities of License Contract Review Teams
28	Electronics Technology, Area 20, Basic Facts and Background
29	Overview of Bell Laboratories - Chapter 2
30	A Specific: Budget Management; A Specific Management Training for Supervising MTS
31	Fundamental and Specific Development Activities - Chapter 5
32	Steering Committee Report

Exhibit No.	Title or Description
33	Presidents' License Contract Committee Final Report and Recommendations
34	License Contract Study of BTL -- July 1973
35	Iowa State Commerce Commission Decision Issued June 9, 1977
36	Exhibit to testimony of David A. Kosh
37	Exhibit to testimony of Mark Langsam
38	Exhibit to testimony of Richard D. Gardner
39	Colorado Intrastate Revenues, License Contract, BIS, Cost Share, and Conduit Expenses
40	Exhibit to testimony of James D. Grundy
41	Exhibit to testimony of Craig Merrell
42	Allocation of American Telephone and Telegraph Company, Federal Income Taxes, 1976
43	Exhibit to testimony of James A. Richards
44	Mountain Bell calculation of rate base from Staff exhibits
45	Mountain Bell calculation of additional revenue required from Staff exhibits
46	Mountain Bell calculations of rate of return on rate base from Staff exhibits
47	Mountain Bell calculation of rate of return on equity from Staff exhibits
48	Mountain Bell, Arizona Local Coin Messages
49	Mountain Bell - Colorado Denver Metro Sample Coin Telephone Revenue Repression
50	Mountain Bell - Colorado, 20¢ Local Coin Analysis - 1976
51	Curriculum Vitae of Ted J. Fiflis
52	Opinion Memorandum on Job Development Investment Credit - Ted J. Fiflis
53	Arizona Local Coin Messages
54	Article entitled "The Utility Outlook and the Rating Process"
55	Depression Test, Actual Results

Exhibit No.	Title or Description
56	Growth Rates, Earnings Per Share, Dividends Per Share
57	Nominal Versus Real Return on Equity
58	One Year Holding Period, Spread of Stock Returns Over Bond Returns, 1926-1976
59	Utah Public Service Commission Report and Order and Notice of Hearing in Case No. 76-049-04 issued July 14, 1977
60	Letter from Internal Revenue Service to Public Service Commission, State of New Mexico
61	Letter from Internal Revenue Service to Department of Public Utilities, City of Dallas, Texas
62	Calculation of Spreads Between Equity and Debt for One Year Holding Periods
63	Growth in Book Value, Earnings Per Share and Dividends, 1971-1976
64	Hearing Requests by Mr. Swift during cross-examination of Norman W. Leake, ML-123
PHASE II	
65	Exhibit to testimony of Roger T. Fuller
66	Exhibit to testimony of Glenn H. Brown
67	Exhibit to testimony of George J. Parkins
68	Elasticities studies on main key dial PBX and key behind PBX markets (sealed)
69	Copy of Colorado Public Utilities Commission Decision No. 90248 in I&S Docket No. 1067 and Case No. 5703
70	Service Charges (No Suspension/Restoral Data) - Colorado
71	Suspension of Service - Colorado
72	Restoration from Denial for Nonpayment - Colorado
73	Responses to Mountain Plains' First Set of Interrogatories and Requests for Production of Documents, MPC-107
74	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977 Attachment No. 1

Exhibit No.	Title or Description
75	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 2
76	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 5
77	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 6
78	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 7
79	A Study of Subscriber Reaction to a New Denver Telephone Service, Prepared for Mountain Bell Telephone by Tracy-LockeAdvertising and Public Relations Research Department, May 1976
80	Training Manual entitled "Selling Telephone Service"
81	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 10
82	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Attachment No. 14
83	Colorado Public Relations Department Answers to Mountain Plains Questions, August 5, 1977, Question No. 35
84	Letter from Ken Love, Colorado Consumer Affairs Supervisor, Mountain Bell, to Bruce Coles, dated July 1, 1977
85	Exhibit of Roger T. Fuller on Impact of Expanding Either City Plan Calling or Two-party Measured Service
86	Exhibit to testimony of Norman W. Leake
87	Exhibit to testimony of B. Floyd Bennett, Jr.
88	Answer (and Question No. 10) re how Mountain Bell derived 2% development for 2MR and 1UR Service

FINDINGS OF FACT

Based upon the evidence of record, it is found as fact that:

1. Mountain Bell is a public utility engaged in the business of providing telephone utility service both intrastate and interstate within the State of Colorado and other states. Pursuant to the provisions of C.R.S. 1973, 40-1-103, the Company's intrastate telephone business within the State of Colorado is subject to the jurisdiction of the Commission, and the Commission has jurisdiction over the subject matter herein.

2. Mountain Bell is a subsidiary of American Telephone and Telegraph Company, which owns in excess of 88% of Mountain Bell's outstanding common stock. The American Telephone and Telegraph Company has a number of other operating subsidiaries similar in nature to Mountain Bell, and, in addition, has a manufacturing subsidiary, Western Electric Company, and a research subsidiary, Bell Telephone Laboratories. The entire group of companies, including the American Telephone and Telegraph Company, Mountain Bell, Western Electric Company, Bell Telephone Laboratories, and other operating companies, which are subsidiaries of the American Telephone and Telegraph Company, comprise what is known and generally referred to herein as the "Bell System."

3. The separation of revenues, expenses, plant, and investment of the Company located in the State of Colorado between interstate and intrastate use is determined by the use of the Separations Manual adopted by the Federal Communications Commission and the National Association of Regulatory Utility Commissioners. The Separations Manual for the purposes of this proceeding, is approved by the Commission as the proper method of determining the proportionate share of intrastate revenue, expenses, plant, and investment, and the actual accounting data presented in this proceeding correctly reflect the application of said Separations Manual to determine the amounts applicable to intrastate telephone service.

4. The proper test year for determination of revenue requirements for Mountain Bell intrastate operations in this proceeding was prescribed in Decision No. 90504, entered by the Commission on April 13, 1977, and is the 12 months ended December 31, 1976, with accounting adjustments as found in Finding No. 11 below, in-period revenue adjustments as found in Finding No. 12 below, in-period expense adjustments as found in Finding No. 13 below, and out-of-period expense adjustments as found in Finding No. 14 below.

5. The average-year 1976 rate base of the Company as booked consists of the following:

(a)	Plant in service	$976,901,000
(b)	Less - Depreciation reserve	154,428,000
(c)	Plant under construction	40,198,000
(d)	Property held for future use	1,640,000
(e)	Material and supplies	6,795,000
(f)	Less - Deferred income taxes and accelerated depreciation	70,272,000
(g)	Total rate base (as booked)	800,834,000

6. Average-year 1976 rate base (as booked) is adjusted by the following in-period adjustments:

(a)	Plant under construction	($ 3,985,000)
(b)	Pre-1971 unamortized investment tax credit	(1,578,000)
(c)	Total in-period adjustments	(5,563,000)

7. Average-year 1976 rate base for the purposes of this proceeding, consists of the following:

(a)	Plant in service	$976,901,000
(b)	Less - Depreciation reserve	154,428,000
(c)	Plant under construction	36,213,000
(d)	Property held for future use	1,640,000
(e)	Materials and supplies	6,795,000
(f)	Less - Pre-1971 unamortized investment tax credit	1,578,000
(g)	Less - Deferred income taxes and accelerated depreciation	70,272,000
(h)	Total rate base	795,271,000

8. The booked revenues of the Company derived from its intrastate telephone operations in the State of Colorado during the 12 months ended December 31, 1976, is $346,535,000, less uncollectible revenue of $1,309,000, for a net total operating revenue of $345,226,000. The booked expenses of Mountain Bell for the same period, including taxes,

applicable to its intrastate telephone operations in the State of Colorado is $278,686,000. After deducting total booked operating expenses, including taxes, from total booked operating revenues, Mountain Bell's net operating income derived from its intrastate telephone operations in the State of Colorado in the test year is $66,540,000.

9. Interest charged to construction during the test year applicable to Mountain Bell's Colorado intrastate operation is $3,313,000, which must be added to net operating income if telephone plant under construction is included in rate base. Miscellaneous deductions during the test year applicable to Mountain Bell's Colorado intrastate operation is $465,000, which must be deducted from net operating income of the Company. Booked net operating earnings is $69,388.000.

10. Other charges - net, during the test year applicable to Mountain Bell's Colorado intrastate operation is $316,000, which must be subtracted from net operating earnings. Interest on debt during the test year applicable to the Company's Colorado intrastate operation is $27,078,000, which must be subtracted from net operating earnings. Booked net income for the test year is $41,994,000.

11. Net income of Mountain Bell derived from its Colorado intrastate operations for the test year is adjusted by the following accounting adjustments:

(a) Payments made to independent telephone companies in the State of Colorado that were applicable to the period 1972 through 1975; payments made to independent telephone companies in the State of Colorado in January 1977 applicable to the year 1976 . . . . . $101,000

(b) Expenses incurred by Mountain Bell to promote the passage of federal legislation known as the Consumer Communications Reform Act of 1976 . . . . . $ 13,000

(c) Expenditures incurred by Mountain Bell in connection with proposed Amendment Nos. 9 and 10 appearing on November 1976 general election ballot in Colorado $181,000

(d) Expenses incurred by Mountain Bell that were reported by registered lobbyists to Colorado Secretary of State . . . . . $ 10,000

(e) Federal and state income tax accrual adjustments booked during the test year relating to prior years . . . . . ($199,000)

(f) Other tax accruals relating to prior years that were booked during the test year . . . . . ($102,000)

(g) Adjustments to the booked ad valorem tax accruals for the year 1976 . . . . . $ 92,000

(h) Adjustment to general service and license expense relating to the Consumer Communications Reform Act of 1976 during the test year . . . . . $ 1,000

Total accounting adjustments to be added to net income of the Company derived from its Colorado intrastate operations for the test year is $97,000.

12. Net income of Mountain Bell derived from its Colorado intrastate operations for the test year is adjusted further by the following in-period revenue adjustments:

(a) Annualization of revenue changes resulting from directory assistance charging, authorized by Decision No. 87701, dated October 30, 1975, effective July 1, 1976 . . . . . $785,000

(b) Annualization of revenue changes resulting from increase from 10¢ to 20¢ per call in the charge for local calls from public and semi-public telephone stations, authorized by Decision No. 87701, dated October 30, 1975, implemented at different times during 1976 . . . . . $2,224,000

(c) Annualization of revenue changes resulting from reclassification of Basalt and Rifle exchanges, and toll exception rate change for first three minutes of calling time for direct-distance-dialed calls from Basalt to Aspen and Aspen to Basalt . . . . . $ 5,000

(d) Annualization of revenue changes resulting from Switched Network Services, authorized by tariffs filed with Advice Letter No. 1190, dated March 17, 1976 . . . . . ($ 24,000)

(e) Annualization of revenue changes resulting from increase in 1976 directory advertising rates $456,000

Total annualized, in-period, pro forma revenue adjustments to be added to net income of the Company for the test year is $3,446,000.

13. Net income of Mountain Bell derived from its Colorado intrastate operations for the test year is adjusted further by the following in-period pro forma expense adjustments:

(a) Annualization of cost-of-living increase of 5.2% and average 2.8% general wage increase to craft and clerical employees, effective August 1, 1976; and annualization of average 6% salary increase to certain supervisory and technical employees, effective September 12, 1976 . . . . . ($2,298,000)

(b) Annualization of interest expense reduction relating to refinancing of debt $296,000

(c) Annualization of detailed billing of monthly recurring services provided to all single-line customers on periodic basis or upon request as directed in Decision No. 87701, dated October 30, 1975, effective August 1, 1976 . . . . . ($ 17,000)

(d) Normalization over three-year period of rate proceeding expenses . . . . . ($ 7,000)

(e) Adjustment to reflect elimination of all advertising expenses by Mountain Bell $613,000

(f) Adjustment to reflect elimination of contributions, fees, and dues, except trade association fees and dues $116,000

(g) Adjustment to 1976 federal income taxes to reflect allocation of a portion of the Bell System tax savings to Mountain Bell's Colorado intrastate operations $707,000

(h) Adjustment to general service and license agreement to reflect reduction to 1% of gross revenues, less uncollectibles $1,204,000

Total annualized, in-period, pro forma expense adjustments to be added to net income of the Company for the test year is $614,000.

14. Net income of Mountain Bell derived from its Colorado operations for the test year is adjusted further by the following out-of-period pro forma expense adjustments:

(a) Annualization of 8.08% wage increase for craft and clerical union employees, effective August 6, 1977; annualization of 6.6% salary increase for first-level management employees, effective September 18, 1977; annualization of salary increases for second-level management employees during months of November and December 1977; and annualization of pension benefit increase for all employees, effective August 17, 1977 . . . . . ($1,482,000)

(b) Annualization of Social Security tax increase, effective January 1, 1977 . . . . . ($ 72,000)

(c) Annualization of increase in pension accrual rate, effective January 1, 1977 . . . . . ($ 251,000)

Total annualized out-of-period pro forma expense adjustments to be deducted from net income of the Company for the test year is $1,805,000.

15. After making the necessary and proper adjustments, as set forth above in Finding Nos. 11 through 14, the adjusted net income of the Company derived from its Colorado intrastate operations in the test year is $44,346,000, or a rate of return on rate base of 8.95%, which is below a fair and reasonable rate of return.

16. A fair rate of return applicable to rate base and valuation of property of the Company devoted to intrastate telephone service in the State of Colorado during test year is 9.40%, which rate of return is, and will be, necessary and adequate to cover the costs of debt of the

Company, to provide for a return on the average-test-year unamortized balance of the Job Development Investment Credit of 9.47%, and to provide for a reasonable return on the equity capital of the Company of 11.5%.

17. The fair and reasonable requirement of net operating earnings, after applying the fair rate of return of 9.40% to the value of the Company's property devoted to intrastate telephone service in the State of Colorado in the test year is $74,755,000.

18. The difference between the required net operating earnings based upon fair and reasonable rate of return as applied to Mountain Bell's Colorado intrastate telephone operations in the test year and the actual net income, as adjusted for the same period, amounts to an earnings deficiency of $3,614,000. In order to produce $1 of net income, a revenue increase of $2.1340 is required considering the applicable franchise and corporate income tax rates. Therefore, an increase in revenue in the amount of $7,712,000 is required to offset the net operating earnings deficiency stated above. This is a modification of the gross revenue increase of $4,558,000 found in Decision No. 91106, as a result of the 1977 compensation increase.

19. Average common equity of the Company applicable to its Colorado intrastate operations during the test year is $388,343,000, and consists of the following:

(a)	Capital stock	$199,855,000
(b)	Premium on capital stock	50,412,000
(c)	Retained earnings	138,076,000

20. Average debt of the Company applicable to its Colorado intrastate operations during the test year is $364,738,000, and consists of the following:

(a)	Bonds	$340,151,000
(b)	Interim debt maturing within one year	197,000
(c)	Advances from AT&T	6,072,000
(d)	Bank loans and commercial paper	18,318,000

21. Average unamortized balance of the Job Development Investment Tax Credit during the test year is $25,490,000.

22. Fixed charges (interest on debt and related expenses of issuance) applicable to Mountain Bell's Colorado intrastate operations during the test year are $26,479,000. Interest expense must be increased by $891,000 to reflect proper end-of-period embedded costs of debt, giving a total adjusted interest expense of $27,370,000.

23. Return of the average unamortized balance of the Job Development Investment Credit during the test year, at 9.47% total cost of capital, is $2,414,000.

24. Of the net operating earnings of $74,755,000 found to be fair, reasonable, and necessary in Finding No. 17 above, after subtraction of fixed charges of $27,370,000, as found in Finding No. 22; subtraction of miscellaneous deductions of $316,000, as stated in Finding No. 10; and, subtraction of the return on unamortized Job Development Investment Credit of $2,414,000 as found in Finding No. 23, the amount available for common equity applicable to Mountain Bell's Colorado intrastate operations for the 12 months ended December 31, 1976, would be $44,655,000, resulting in a rate of return on common equity of 11.5%, which is a fair, just, and reasonable return and is sufficient and necessary to cover dividend requirements, to accumulate a reasonable surplus, to enable the Company to maintain its credit and to raise capital on reasonable terms, and to assure financial integrity of the Company.

25. Total revenue requirement, excluding interest charged construction and including uncollectible revenue, of Mountain Bell to be derived from its Colorado intrastate telephone operations on the basis of test-year conditions is $360,098,000.

26. The rates of return found to be proper for ratemaking purposes in this proceeding, to wit: 9.40% on rate base and 11.5% on common equity are compatible with and can be applied only to the other conditions as found herein. Any material change in the rate base found proper herein would of necessity involve a change in the fair rate of return; otherwise, the end result of equity earnings would be in error. Likewise, a fair return on equity as found herein applies only to the conditions of risk now applicable to the common equity and any change in the capital structure by way of increased or decreased debt ratio, may necessitate an adjustment to the 11.5% rate of return on equity found to be fair and reasonable in this proceeding.

27. The rates and charges as proposed by Mountain Bell in the tariffs accompanying Advice Letter No. 1279, under investigation herein, would, under the test-year conditions, produce additional gross revenue not to exceed $50,588,000, or a total annual revenue (including uncollectible revenue) of $399,776,000. To the extent that revenue produced by such rates and charges would therefore exceed Mountain Bell's revenue requirements as found in Findings No. 18 and No. 25, respectively, such rates and charges are not just and reasonable.

28. The $7,712,000 increase in gross revenues found to be necessary to offset the net earnings deficiency will be generated from the Company's Colorado intrastate operations by adjusting tariff charges as follows:

(a)	Service Charges:	
	(1) Service charge restructuring as proposed by Mountain Bell	$109,000
	(2) Suspension and restoral of service charges restructuring as proposed by Mountain Bell	($109,000)
	(3) Service charge increases for residential prewiring and business service order	$769,248
(b)	Service Station Service Charge Restructuring as proposed by Mountain Bell	$ 8,500
(c)	Four-Party Service - Standardization of Mileage Charge as proposed by Mountain Bell	($ 370)
(d)	Eight-Party Mileage Restructuring as proposed by Mountain Bell	$ 62,400
(e)	Local Exchange Service Rate Increase as proposed by Mountain Bell	$773,000
(f)	Intrastate Toll Increase	$3,049,611
(g)	Business Terminal Telephone Equipment (obsolete tariff customers only) Increase	$3,049,611

29. Low-cost 2MR and 1UR Service should be made available to all customers in the State of Colorado presently served by a central office equipped with No. 1 or No. 2 Electronic Switching System (ESS), and to all customers in the future served from a central office equipped with No. 1 or No. 2 ESS, or comparable equipment.

30. Colorado Municipal League should be reimbursed by Mountain Bell for attorneys' fees and costs and expert witness' fees and costs in the sum of $44,216.22 as follows: $10,615 as attorneys' fees, $2,169.22 as attorneys' costs, $30,000 as expert witness fee for David A. Kosh, and $1,432 as expert witness costs for David A. Kosh.

DISCUSSION

1. Capital Structure.

Mountain Bell recommended in this proceeding use of a hypothetical average-year 1977 equity for purposes of its recommended capital structure. Use of a hypothetical average-year 1977 capital structure was recommended in order to reflect the effects on its capital structure of a $192,436,062-common-stock issue, issued in April 1977. Mountain Bell argued that a capital structure reflective of the actual capital structure of the Company at the time the rates go into effect should be used in this proceeding. The capital structure recommended by Mountain Bell in this proceeding consists of 45.5% debt and 54.5% equity.

Staff made no recommendations with respect to a proper capital structure to be used in this proceeding. Intervenors Municipal League and AMAX recommended use of a consolidated Bell System hypothetical capital structure consisting of 51% debt, 4% preferred and 45% common equity. Municipal League and AMAX reasoned that since the debt issuances of Mountain Bell are so intertwined with debt issuances of other Bell operating companies and that since American Telephone and Telegraph Company owns in excess of 88% of the common equity of Mountain Bell that it would be more appropriate to use in this rate proceeding the capital structure of the consolidated Bell System with certain modifications. Intervenor General Services Administration recommended use of the actual capital structure at year-end 1976 of the consolidated Bell System, consisting of 49% debt, 4% preferred stock and 47% common equity. General Services Administration recommended use of the actual capital structure of the Bell System because it is a simple and straight-forward procedure which introduces no distortions into the calculation of the overall cost of capital.

The capital structure utilized by the Commission in this rate proceeding is the average-year capital structure for Mountain Bell during the test-year 1976, adjusted to reflect the effects of the refinancing

of debt by issuance of $150,000,000 of 40-year 7-7/8% debentures on November 15, 1976, and $75,000,000 of 5-7/8% notes on December 29, 1976. For purposes of calculating rate of return on common equity, the Commission utilized the capital structure consisting of 48.43% debt and 51.57% common equity.

In its calculations, the Commission has rejected Mountain Bell's use of the hypothetical average-year 1977 capital structure. No other adjustments to the capital structure were made by Mountain Bell to reflect changes in the capital structure as the result of the issuance of long-term debt, or changes in short-term debt financing that have and are planned for 1977. The Commission takes administrative notice of the public fact that Mountain Bell has had a number of debt issues in calendar year 1977, in addition to its stock issue. However, none of the debt issues was taken into consideration in its recommended capital structure. The Commission has also rejected the recommendation of the General Services Administration to use the actual consolidated capital structure for the Bell System and the recommendation of Municipal League and AMAX to use a hypothetical capital structure for the consolidated Bell System because of a recent opinion of the Colorado Supreme Court.

On August 2, 1977, the Supreme Court rendered its opinion in Peoples Natural Gas Division of Northern Natural Gas Company v. Public Utilities Commission, ___ Colo. ___, 567 P.2d 377 (1977). Although the Court affirmed the Commission's use of a hypothetical capital structure for Peoples Natural Gas Division, the Court wrote with respect thereto on pages 4 through 6:

> A guiding principle of utility regulation is that management is to be left free to exercise its judgment regarding the time of entering financial markets and its judgment regarding the most appropriate ratio between debt and equity in the capital structure. E.g., Northwestern Bell Telephone Company v. State of Minnesota, 299 Minn. 1, 216 N.W. 2d 841 at 850 (1974). In Mountain States Telephone and Telegraph Co. v. PUC, 182 Colo. 269 at 281-282, 513 P.2d 721 at 727 (1973), we stated:

> "...that methods of raising capital should be left to the discretion of management unless there is a substantial showing that rate payers are being prejudiced materially by the managerial options in the area of capital financing."

> . . . Unless it has been demonstrated by a substantial showing that ratepayers are materially prejudiced by the actual capital structure which finances utility operations, the PUC should use the actual capital structure in calculating rates. Mountain States Telephone and Telegraph Co. v. PUC, supra.

> * * *

> . . . We agree with the Supreme Judicial Court of Massachusetts that a utility regulatory authority cannot base rates on a hypothetical rather than the actual capital structure of a utility unless "existing capital structures of regulated companies ...so unreasonably and substantially vary from usual practice as to impose an unfair burden on the consumer." Mystic Valley Gas Co. v. Department of Public Utilities, 359 Mass. 747, 269 N.E. 2d 233 at 239 (1971); New England Telephone and Telegraph Co. v. Dept. of Public Utilities, 360 Mass. 667, 275 N.E. 2d 493 at 507-509 (1971); also see Southern Bell Telephone and Telegraph Co. v. Mississippi Public Service Comm'n, 237 Miss. 157, 113 So. 2d 622 (1959) (regulatory authority granted right to adopt a hypothetical capital structure after actual capital structure found "imprudent and uneconomical").

Inasmuch as the Court's opinion was rendered following the close of hearings in Phase I in this I&S Docket No. 1108, neither Municipal League, AMAX nor General Services Administration could have anticipated the above quoted language from Peoples Natural Gas Division v. Public Utilities Commission, supra, relative to the findings the Commission must make in order to sustain use of a hypothetical capital structure for Mountain Bell. The evidence offered by Municipal League, AMAX and General Services Administration in this proceeding consequently is insufficient to warrant the Commission's using either the actual consolidated Bell System capital structure, or a hypothetical consolidated Bell System capital structure.

It should not be construed by one reading this decision that the Commission has found the capital structure employed in this proceeding, to wit: 48.43% debt and 51.57% common equity, is a proper debt-equity ratio for a telephone utility such as Mountain Bell. Such

a capital structure is, in the opinion of the Commission, weighted too heavily towards equity. However, there is insufficient evidence in this record for the Commission to determine whether such a debt-equity ratio for Mountain Bell is "'. . . so unreasonably and substantially var[ied] from usual practice as to impose an unfair burden on the consumer.'" It further should not be interpreted that this Commission has rejected adjusting Mountain Bell's actual capital structure in future rate proceedings to reflect the effects of double leveraging due to American Telephone and Telegraph Company's ownership of more than 88% of the common equity of Mountain Bell.

2. Rate of Return on Common Equity

In this proceeding, the Commission heard testimony from six witnesses on the issue of fair rate of return on common equity. Mountain Bell sponsored three witnesses, Dr. Ezra Solomon, Dr. George D. Christy, and William T. Danner. Intervenor Colorado Municipal League sponsored one witness, David A. Kosh. Intervenor General Services Administration sponsored one witness, Mark Langsam; and the Staff of the Commission sponsored one witness, James A. Richards. In descending order, the following fair rates of return on common equity were recommended to the Commission:

(a) William T. Danner - 14.0% to 15.0%

(b) Ezra Solomon - 14.25% to 14.75%

(c) Mark Langsam - 11.5% to 12.5% (12.0% specifically)

(d) James A. Richards - 11.5% to 12.3%

(e) David A. Kosh - 11.25% to 11.5%

Dr. Christy was called by Mountain Bell solely as a rebuttal witness and did not recommend a fair rate of return. Dr. Christy, however, did endorse the methodologies employed by Dr. Solomon and Mr. Danner.

After analyzing the methodologies used by the various witnesses, including the capital structures utilized to reach the recommended fair rates of return, the Commission has concluded, as is stated in Finding of Fact No. 24, that a fair rate of return on common equity for Mountain Bell, considering the economic and market conditions that exist today,

is 11.5%. In this regard, the Commission feels that some comment should be made with respect to the methodologies employed by the witnesses, especially the debt-equity differential methodology employed by Mountain Bell's witnesses.

The formula used in this methodology by Dr. Solomon and Mr. Danner may be stated as follows:

$$RRR = i + X,$$

where "RRR" is a nominal rate of return on common equity, "i" is the rate of return on a selected portfolio of high-grade corporate bonds, and "X" is a calculated differential between holding a large number of corporate equities and holding a small selected portfolio of corporate bonds. The differentials of 6.5% and 5.5% reached by Mountain Bell's witnesses were based upon two studies, one by Professors Irwin Friend and Marshall Blume, entitled "The Demand for Risky Assets," and one by Professors Roger Ibbotson and Rex Sinquefield, entitled "Stocks, Bonds, Bills and Inflation; Year by Year Historical Returns, 1926-1974." The Friend study covers the period 1902 to 1971, and the Ibbotson study covers the period 1926 to 1974. Both studies provide year-by-year yields achieved by investors on (1) a portfolio of high-grade corporate bonds and (2) a portfolio of common stocks. The portfolio of common stocks used in the Friend study includes all stocks listed on the New York Stock Exchange for the period 1902 to 1971. The portfolio of common stocks used in the Ibbotson study includes all stock on the Standard and Poor's 500 Stock Index for the period 1926 to 1974. The portfolio of high-grade bonds used in the Friend study numbered less than 50, all rated Aaa or Aa. The portfolio of high-grade corporate bonds used in the Ibbotson study encompassed a portfolio of 17 high-grade corporate bonds, known as the "Salomon Brothers Index."

The equity-debt yield differential methodology employed by Mountain Bell in this proceeding, in the opinion of the Commission, has several very serious deficiencies and biases. The most serious deficiency

is that the 6.5% and 5.5% equity-debt yield differentials arrived at are nothing more than historical averages for the periods studied, weighted on the high side because of the universes employed in the study and the method of calculation. First of all, there is no evidence that the historical averages arrived at have any relevance to investors in today's market, even with respect to industrial corporations, let alone utility corporations, or Mountain Bell specifically. If one tests these historical averages, as was done at the hearing, one finds that starting with a holding period of 1974 through 1976 (three-year holding period), the equity-debt yield differential is negative for all holding periods through the nine-year holding period, 1968 through 1976. One also finds that the equity-debt yield differential does not reach or exceed 5.5% until the 23-year holding period, 1954 through 1976. The Commission heard evidence that the average holding period for Mountain Bell stock (Mountain Bell's minority stockholders) is 11 years. The equity-debt yield differential for the 11-year holding period, 1966-1976 is +0.1%. If this differential were added to the 7.875% interest rate on Mountain Bell's November 15, 1976 bond issue, the rate of return on common equity for Mountain Bell would be 7.975%, obviously too low! Such testing demonstrates to this Commission the irrelevancy in today's market of using the equity-debt yield differential as a measure for determining fair rate of return.

In addition to its irrelevancy in today's market, the 5.5% and 6.5% equity-debt yield differentials are weighted on the high side. This results, first of all, from the universes that are being compared. The universes compared in the Friend study are the portfolio of all stocks traded on the New York Stock Exchange for the period studied, 1902 through 1971. The quantity of stock in this portfolio fluctuates between 1,000 and 2,000 in number. This portfolio is then matched year-by-year against a portfolio of high-grade corporate bonds numbering less than 50, all rated Aaa or Aa. It is obvious that a portfolio of all

stocks traded on New York Stock Exchange would have more risk than a portfolio of corporate bonds, all rated either Aaa or Aa. Thus, the differential between the weighted average yield of a portfolio of corporate stocks and of a small number of high grade corporate bonds would be higher than the differential derived from a comparison of the yields of comparable risk stocks and bonds. Thus, the studies yield larger equity-debt differentials than would be attained with the use of comparable universes. In addition, to the extent that the studies employed arithmetic averaging, this would also tend to bias the resulting equity-debt yield differential in the same direction. Furthermore, using universes of corporate equities and corporate bonds as compared to universes of utility stocks and bonds also would tend to bias similarly the equity-debt yield differential.

The same comments are germane to the Ibbotson study which compared universes consisting of a portfolio of all stocks encompassed in the Standard and Poor's 500 Stock Index and a portfolio of 17 high-grade corporate bonds making up what is called the "Salomon Brothers Index."

A brief comment is in order with respect to Dr. Solomon's application of the equity-debt risk differential specifically to Mountain Bell. The Commission could not disagree more with Dr. Solomon's choice of a base period of 1960-1965. This was a period in which Mountain Bell's common stock was selling well in excess of 1.2 of book and its pre-tax interest coverage was around 7.3 times earnings. Earnings which would generate such ratios are, in the opinion of the Commission, unduly excessive and could be characterized as monopoly pricing. The Commission would hardly agree with Dr. Solomon that this was a golden age to be recaptured.

Each of the remaining three rate-of-return witnesses, Messrs. Kosh, Langsam and Richards utilized variants of the "discounted cash flow" (DCF) methodology. Mr. Langsam referred to his DCF analytical approach as a "market value approach." In addition, Mr. Langsam used a second methodology at arriving at his recommended rate of return, which he referred to as "comparable earnings approach."

The DCF methodology basically states that the capitalization rate for a particular stock is equal to the dividend yield, plus growth, which may be stated in the formula

$$i = y + g,$$

where "i" is the capitalization rate, "y" is the current dividend yield (measured by dividing dividend per share by the average market price per share) and "g" is the growth. Although all three witnesses utilized the DCF methodology, each used a different method of measuring "g". Even though different techniques were used to measure "g" and different allowances were made to compensate for market pressure in order to keep market-to-book ratio above one, their DCF recommended fair rate of return fell within a very narrow range. Mr. Kosh's recommended rate was in the range from 11.25% to 11.5%. Mr. Richards' recommended rate was in the range from 11.5% to 12.3%. Mr. Langsam recommended a fair rate of return on common equity using the market value approach, in the range from 11% to 13%, which Mr. Langsam characterized as already including allowance for market pressure.

The Commission has in past rate proceedings found the discounted cash flow formula acceptable for determining a fair rate of return on common equity, because it measures investor's expectations. Recognized in the DCF formula are investors' perceptions of future dividend yields plus the expected growth in capital value which will be realized through the change in market price when the stock is sold. As this Commission has stated before, however, and as has been recognized by the courts, the finding of a fair rate of return is not an exact science.

In the Commission's opinion, 11.5% is a fair rate of return on common equity for Mountain Bell in today's market. Eleven and one-half percent is sufficient to cover dividend requirements, to accumulate a reasonable surplus, and to enable Mountain Bell to maintain its credit; is sufficient to raise capital on reasonable terms, and to assure the financial integrity of the Company; and is commensurate with returns on investments in other enterprises having corresponding risks.

The 11.5% rate of return found fair and reasonable by the Commission in this proceeding is the rate of return on common equity recommended by Mr. Kosh in December 1974 in Investigation and Suspension Docket No. 867. Mountain Bell's then "authorized" rate of return was 11.4%. In discussing Mr. Kosh's recommended rate of 11.5%, this Commission wrote in Decision No. 86103, in Investigation and Suspension Docket No. 867, at page 15:

> In today's market, Mountain Bell stock has been selling at approximately 75% of its book value and the rate of return to Mountain Bell equity is close to what Mr. Kosh now recommends. Realistically, we find that it is necessary to adjust Mr. Kosh's figures upward in order to take into account the unsettled conditions in today's capital markets and the depressed state of utility stocks, including Mountain Bell.
>
> We entertain no illusion that even our upward adjustment of Mr. Kosh's recommended rate of return to equity from 11.5% to 12.04% will have a significant impact in raising the market price of Mountain Bell stock, let alone lifting it to a level of 1.2 of book, in the near term market. By the same token, it is also clear to us that Mr. Kosh's suggested rate of return of 11.5% likewise is too low to raise Mountain Bell stock to 1.2 of book in the near term.

The market conditions in December 1974 were indeed very bleak, the market being at the bottom of its then bear market. The economic conditions that existed in December 1974 were also very bleak. Both, however, have improved between that time and the present. It was brought out in cross-examining of Mr. Danner that in December 1974, Mountain Bell stock sold

at a low of 15-7/8 and a high of 17-5/8. Mountain Bell's resulting market-to-book ratio was .69 on the low side and .77 on the high side. On the day preceding cross-examination of Mr. Danner, Mountain Bell's stock closed at 28-1/8. As was brought out in the cross-examination, the book value of Mountain Bell's stock was approximately $25.00 in June 1977 at the time of the hearings herein. This yields a market-to-book ratio of 1.125. The dramatic increase in the market price of Mountain Bell's stock to a point where it was selling at 1.125 of book was accomplished during two years in which Mountain Bell's realized return on book equity was 10.89% (in 1975) and 11.46% (in 1976). As was stated above in the quotation from Decision No. 86103, the Commission increased the authorized rate of return from 11.4% to 12.04% in recognition of the unsettled conditions in the capital markets of the country at that time and the depressed state of utility stocks. Neither condition exists today. As was stated by Mr. Justice Butler in the 1923 landmark decision, Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 693 (1923): "A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally." The money markets and business conditions that existed generally in December 1974, no longer exist. It is the Commission's opinion that the rate of return of 12.04%, which was authorized in Decision No. 86103 on December 20, 1974, has become too high by virtue of changes affecting opportunities for investment. Accordingly, the Commission has determined to adjust the rate of return on common equity in recognition of the general improvement in financial markets and the decrease in the cost of capital since Decision No. 86103.

3. General Service and License Agreement.

Considerable evidence was offered in this proceeding by American Telephone and Telegraph Company and Mountain Bell relative to that item of operating expense known as the "General Service and License Agreement"

expense (hereinafter referred to as "license" expense). In addition, considerable cross-examination of American Telephone and Telegraph witness James T. Gibbons was conducted by Municipal League and AMAX. In addition, Municipal League and AMAX offered testimony of Richard D. Gardner, who recommended that this Commission adopt an allocation procedure for the license expense similar to that utilized by the California Public Utilities Commission.

The subject agreement is one executed by American Telephone and Telegraph Company and Mountain Bell on August 5, 1930. For the period from 1948 to October 1, 1974, AT&T accepted payment under the agreement from its operating companies, including Mountain Bell, in the amount of 1% of gross revenues, less uncollectibles. By letter, dated June 3, 1974, from Mr. John D. deButts, Chairman of the Board of AT&T, to Mr. Robert K. Timothy, President of Mountain Bell, AT&T changed the billing from 1% of gross revenues, less uncollectibles, to an allocated share of the total costs, including a return on investment, associated with providing services under the license contract. The change in billing was apparently prompted by a growing deficit between the costs incurred by the General Department of AT&T in providing services under the license contract and the revenues being collected under the 1% fee.

The change in billing may have solved the deficit problem faced by the General Department of AT&T, but it has created severe problems for commissions such as the Colorado Public Utilities Commission, which are charged with the duty of verifying not only the license expense, but also the performance of the services for which the expense is a charge. From the evidence in this proceeding, it appears that Mountain Bell regularly and routinely pays the monthly bill submitted to it by AT&T for services under the license agreement without question, and even before the detailed backup material is made available for verification. To compound this lack of verification by Mountain Bell, when the Staff of the Commission

performed its audit in this proceeding, Mountain Bell provided the Staff with no backup material or explanation, although both were requested and available, other than the gross figure that Mountain Bell would include as an item of expense for ratemaking purposes.

The lengthy cross-examination of AT&T witness James T. Gibbons demonstrated to this Commission the necessity for an audit of not only the books of the General Department of AT&T, but also for a performance audit of the General Department with respect to services performed under the license agreement. Even if this Commission had jurisdiction to audit the General Department of AT&T, it is obvious that a commission of the size of the Colorado Public Utilities Commission has neither the personnel nor financial resources to perform such an audit, nor to pay to have such an audit performed. The cross-examination of AT&T witness James T. Gibbons raised four fundamental problems, inasmuch as the method of billing has been changed: (1) Services are performed by the General Department of AT&T that are for the benefit solely of the investors of AT&T and are billed to the operating companies through the license agreement; (2) services are performed by the General Department of AT&T that are of benefit to and of interest only to AT&T as a parent corporation, and are billed to the operating companies; and, (3) services are performed by the General Department of AT&T in areas in which the Bell System is in continuing vigorous competition, and are billed generally without segregation to the operating companies through the license agreement; and, (4) with the change in billing from 1% of gross revenues to an allocated share, there is little restraint upon either Bell Telephone Laboratories or General Department of AT&T to hold costs down. With respect to the latter, the record amply demonstrates that this is a very serious problem, which burden falls upon the ratepayers of the operating telephone companies, such as Mountain Bell. For example,

during the first two years in which the new method of billing has been in effect, the expenses of the General Department billed under the license contract increased 26% and 22.9%, respectively. The Colorado intrastate allocated share for the test-year 1976 increased 27.4% over the prior year. Though under-utilization of employees was cited, the number of employees in the General Department has continued to increase. For example, at year-end 1972, the General Department employed some 4,653 employees. This increased to 4,983 at year-end 1973, to 5,712 at year-end 1974, to 6,188 at year-end 1975. Prior to October 1, 1974, the 1% gross revenues payment acted as a restraint upon the General Department and Bell Telephone Laboratories. With the discontinuance of the 1% fee, there is apparently little effective restraint other than that which is self-imposed, which from the evidence in this proceeding, appears to be slight. Nor does it appear to this Commission that the Bell operating companies (most of which are 100% owned by AT&T, and including Mountain Bell which is more than 88% owned by AT&T) can impose any restraint upon the General Department. Mountain Bell has regularly paid the amount, without question, billed by AT&T before the backup data was supplied. This, coupled with the Company's not providing Staff with backup data for its audit, convinces the Commission that for this proceeding only 1% of gross revenues, less uncollectibles, should be allowed as an operating expense for ratemaking purposes.

4. Job Development Investment Tax Credit.

Mountain Bell maintained in this proceeding that Section 46(f)(2) of the Internal Revenue Code, 26 U.S.C.A. § 46(f)(2) [formerly 26 U.S.C.A. § 46(e)(2)], requires that it be permitted to earn on the unamortized balance of the Job Development Investment Credit (hereinafter referred to as "JDIC") at the rate assigned by this Commission to its common equity. Originally, Mountain Bell asserted that it should be permitted to earn on the unamortized JDIC balance at the debt-equity composite rate.

With regard to treatment of JDIC for ratemaking purposes, Congress has provided three basic elective options: The first option provides that the investment credit is not to be available to the Company with respect to any of its public utility property, if any part of the credit to which it otherwise would be entitled is flowed through to income; however, in this option, the tax benefits derived from the credit (if the regulatory commission so requires) may be used to reduce rate base, provided that this reduction is restored over the useful life of the property. The second option provides that the investment credit is not to be available to a company with respect to any of its public utility property if the credit to which it would otherwise be entitled is flowed through to income faster than over the useful life of the property; however, in this option there may not be any adjustment to reduce rate base, if the credit is to be available. Under the third of the elective options, the above restrictions would not apply at all. Only the first and second options were available to Mountain Bell. The Company made its election of the second option within 90 days after enactment of JDIC, as provided in the statute. Under Section 46(f), if a regulatory commission flows through a utility's investment credit at a rate faster than permitted under the applicable option, or insists upon a greater rate base adjustment than is permitted under the applicable option, then the utility will not be allowed to take any investment credit for that period and for any

taxable periods that are open at the time the limitations of the applicable options are exceeded by the Commission. The second option which Mountain Bell has elected has two specific prohibitions: (1) The Commission, for ratemaking purposes, may not flow the credit through to income faster than ratably over the useful life of the property. In determining the period of time over which the investment may be ratably flowed through, reference must be made to the period of time on the basis of which depreciation expense is computed on the utility's regulated books of accounts, and not to the useful life used for depreciation under the Internal Revenue Code. (2) The Commission, for ratemaking purposes, may make no adjustment with respect to the credit for purposes of reducing rate base.

The Company does not point to language of Section 46(f)(2) in support of its assertion. The Company, instead, points to a paragraph appearing in both House Report No. 92-533 and Senate Report No. 92-437:

> In determining whether or to what extent a credit has been used to reduce the rate base, reference is to be made to any accounting treatment that can affect the company's permitted profit on investment by treating the credit in any way other than as though it had been contributed by the company's common shareholders. For example, if the "cost of capital" rate assigned to the credit is less than that assigned to common shareholders' investment, that would be treated as, in effect, a rate base adjustment.

(United States Code, Congressional and Administrative News, page 1841 and page 1946, 92nd Congress, 1st Session, 1971) A close reading of the above-quoted paragraph, as it appears in the Senate Report, would indicate that it is part of the discussion under Option 1. It is not clear that the Congressional intent would be the same with respect to Option 2, which Mountain Bell has elected. Out of an abundance of caution, the Commission in this proceeding has allowed the Company to earn on the unamortized balance of JDIC, on an average-test-year amount, and at the composite cost of capital. To do otherwise may result in loss of the credit. In the event that a court of law should reverse the Commission, it is presumed that the court would order a refund, with interest. If the court should affirm the Commission, then the ratepayers would not have been prejudiced. In either event, the ratepayers will have been protected.

5. Adjustment to 1977 Federal Income Taxes.

In this proceeding, the Commission has made an adjustment to the amount of federal income taxes claimed by the Company for the test year. The adjustment made by the Commission in this proceeding employs the same methodology that the Commission used in Investigation and Suspension Docket No. 930, and is very similar to the adjustment made by the Commission in Investigation and Suspension Docket No. 867. The methodology is described in detail on pages 26 to 29 of Decision No. 87582 in Investigation and Suspension Docket No. 930. Basically, by this adjustment, an allocated share of the net tax savings retained by the General Department of American Telephone and Telegraph Company, which was derived from filing of a system-wide consolidated federal income tax return, is allocated to Mountain Bell's Colorado intrastate operations. As is shown in Exhibit 42 ("Allocation of American Telephone and Telegraph Company Federal Income Taxes 1976"), the total liability for federal income taxes of the General Department of American Telephone and Telegraph Company for the year 1976 was a negative $189,284,980. By the allocation method employed by the Commission in this proceeding, $707,000 of the net tax savings has been allocated to Mountain Bell's Colorado intrastate operations. As stated previously, the methodology employed by the Commission in this proceeding is identical to the methodology used by the Commission in Investigation and Suspension Docket No. 930, and is very similar to the methodology used by the Commission in Investigation and Suspension Docket No. 867. The adjustment to federal income taxes made by the Commission in Investigation and Suspension Docket No. 867 was affirmed by the District Court in and for the City and County of Denver (Gilbert A. Alexander, Judge) on May 11, 1976, in three consolidated proceedings under the lead case caption: The Colorado Municipal League v. Public Utilities Commission of the State of Colorado, et al., Civil Action No. C-51567 and Civil Action Nos. C-52125 and C-52159. The action of the District Court was appealed

to the Colorado Supreme Court by Mountain Bell. Said appeal has been briefed and argued before the Court and, together with the appeal of the Colorado Municipal League, is awaiting decision. The adjustment to federal income taxes made by the Commission in Investigation and Suspension Docket No. 930 was affirmed by the District Court in and for the City and County of Denver (Edward J. Byrne, Judge) on June 14, 1977, in two consolidated actions under lead case caption: Colorado Municipal League v. Public Utilities Commission, Civil Action Nos. C-60882 and C-61148. The District Court's action affirming the Commission has been appealed to the Supreme Court by Mountain Bell. The allocation of federal income taxes made by the Commission in this proceeding and in the two immediately prior proceedings conforms with the views expressed by the United States Supreme Court in Federal Power Commission v. United Gas Pipe Line Company, 386 U.S. 237 (1962).

6. Advertising.

Mountain Bell included as an item of operating expense during the test period advertising expenses in the amount of $1,240,554. Staff of the Commission recommended elimination of all expenses for advertising on the basis that during the audit by the Staff, the Company, though requested, did not make available to Staff auditors either the backup expense data making up the $1,240,554, or any samples of the advertisements. The Commission in this proceeding has disallowed all advertising expenses of Mountain Bell as items for ratemaking purposes. The disallowance is premised on two bases: (a) Staff of the Commission was not given the opportunity to either audit the components of the expenses included by Mountain Bell for advertising, nor provided samples of advertisements whereby the Staff could have made a judgment based upon prior Commission decisions, and (b) the evidence the Company submitted in this proceeding is not particular enough for the Commission to segregate out those expenses relating to advertisements which would be allowed from those expenses relating to advertisements that would not be

allowed as items for ratemaking purposes. Furthermore, the Commission does not find the "selected samples," included by Mountain Bell in Exhibit No. 5 an adequate substitute for the Staff audit. Mountain Bell during this proceeding expressed confusion with respect to the criteria the Commission was currently using to determine whether or not a particular advertisement would be allowed as an item of operating expense for rate-making purposes. Lest the Company still be in a state of confusion with respect to the Commission's criteria, the following criteria should govern the Company in its next rate filing. The Commission will allow as an item of operating expense those advertisements whose purpose is solely customer informative. Advertisements whose main purpose is image enhancement or promotional will be disallowed, with one exception. That exception is advertisements of products of terminal telephone equipment where the Company is facing competition. Terminal equipment promotional advertising, however, will be assigned as a cost only to the terminal telephone equipment being so advertised. Customer informative advertisements will be allowed by the Commission only if there is sufficient evidence in the record which clearly delineates the benefits to the ratepayer, and the cost relating to the particular advertisment in question.

7. 1977 Wage and Benefit Increase and Productivity Offset.

In Decision No. 91106, entered by this Commission on August 5, 1977, in this proceeding, the Commission wrote, pages 2 and 3:

> The revenue requirement arrived at in this decision for Respondent's Colorado intrastate telephone business does not include any allowance for the proposed 1977 wage and benefit out-of-period adjustment requested by Respondent and opposed by Intervenors and Staff. In the event that a contract is arrived at between the Bell System and the Communications Workers of America prior to September 20, 1977, the Commission at that time will modify the revenue requirement as necessary to incorporate therein the actual wage and benefit increase, net of any unpaid wages and increased overtime payments, due to a strike, if such should occur, less offsets for productivity. Any nonunion salary and benefit increase announced prior to September 20, 1977, effective in the calendar year 1977, will be treated in the same manner as the union wage and benefit increase.

On August 6, 1977, a three-year contract covering national issues was signed by the Bell System and the Communications Workers of America, and on August 13, 1977, a contract was signed between said parties covering local issues. On September 16, 1977, the Communications Workers of America notified Mountain Bell that all provisions of the newly executed contracts had been ratified by the union membership. On August 17, 1977, Mountain Bell notified its employees that salary adjustments would be made for first- and second-level management employees. According to evidence submitted by Mountain Bell, the annualized adjustment for all of the wage and salary increases, and pension and fringe benefit increases would increase total operating expenses on the test-year basis of $10,178,000, which when offset by a 6.1 productivity factor would result in a net increase to operating expenses of $3,766,000. When federal, state and Social Security taxes are taken into consideration, net income, on the basis of the test year, would be reduced an additional $1,662,000. The Commission has determined to accept all of Mountain Bell's recommendations with the exception of that portion of the fringe benefits for the period January 1, 1978, to January 1, 1979. The annualized effect of the fringe benefits effective August 7, 1977, will be accepted. The Commission has determined to reject that portion of the fringe benefits spanning the period of January 1, 1978, to January 1, 1979, as being unreasonably outside the calendar year 1976 test year used in this proceeding. The rejection of this portion of the fringe benefits would result in net income being reduced by a total of $1,482,000 rather than $1,662,000, as proposed by the Company.

Proposals that the Commission utilize only the last two or last three years of productivity as offset to Mountain Bell's wage, salary, fringe benefits and pension adjustments have been recommended by Intervenors in this proceeding. Use of the last three years for calculating the productivity offset would result in a productivity factor

of 9.7, which when applied to the wage, salary, fringe benefits and pension increase would almost totally offset said increase. Utilizing the last two years of productivity would result in a productivity factor of 12.9, which would not only totally offset the wage, salary, fringe benefit and pension increase, but would necessitate a reduction, rather than an increase, in the revenue requirement of Mountain Bell as calculated in Decision No. 91106.

The Commission is of the opinion that the five-year average as proposed and calculated by Mountain Bell in this proceeding would be more fair and equitable.

8. Contributions, Fees and Dues.

Mountain Bell in this proceeding, as it always has in the past, included as an item of operating expenses, contributions made by Mountain Bell to various organizations, and membership fees and dues paid by Mountain Bell on behalf of certain employees of the Company in various social and service organizations. The Commission, as in past proceedings since 1972, has disallowed such expenditures as items of operating expense for purposes of ratemaking. The Commission, however, is making one exception to total disallowance. The exception is with respect to membership fees and dues paid by Mountain Bell on behalf of its employees in trade and technical associations. The Colorado intrastate portion of the trade and technical fees and dues paid by Mountain Bell during the test year totaled $4,191.

9. Revenue Adjustment for Increase in Public and Semi-Public Telephone Calls.

In this proceeding, Mountain Bell has made a revenue pro forma adjustment to net income in the amount of $963,000 to reflect the effects upon booked revenues of the increase from 10¢ to 20¢ a call for calls from public and semi-public telephone stations. Staff in this proceeding challenged Mountain Bell's methodology for calculating the revenue pro forma adjustment, and increased the effects upon net income by some $1,261,000, resulting in a revenue pro forma adjustment to net income of $2,224,000.

The big point of disagreement between Mountain Bell and Staff centered around use of Mountain Bell's repression factor of 24%. Staff took the position in this proceeding that no repression should be utilized inasmuch as Mountain Bell had not sustained its burden of proof, and furthermore had offered neither explanation nor justification to the Staff during the Staff's audit, other than to provide Staff with a single sheet containing numbers derived from a repression study done in Arizona. In its rebuttal case in Phase I, Mountain Bell offered evidence attempting to explain its use of a 24% repression factor (evidence which Mountain Bell should have initially introduced in its direct case, which would have then afforded all parties a fair opportunity to effectively cross-examine said use of a 24% repression factor). After much procedural maneuvering, Mountain Bell offered, and the Commission accepted into evidence, Exhibit No. 48 relating to repression as calculated in studies done in Arizona, El Paso, Texas, and Wyoming. Mountain Bell did not offer any evidence to explain how these studies were conducted, or whether conditions under which the public and semi-public telephone rates were increased in these jurisdictions were in any way comparable to those in Colorado. The Commission finds Exhibit No. 48, without explanation, to be unpersuasive. With respect to Colorado, Mountain Bell offered into evidence a study conducted in Central Office Prefixes 758 and 778, both located in southeast Denver Metropolitan Area. The Commission is unconvinced that said two Central Offices are in any way typical of the Central Offices in other parts of the City of Denver or in the State as a whole. For example, the Central Office which would include Stapleton International Airport, downtown Denver, and areas of the core city where public and semi-public telephones are used by customers as substitutes for private service would have added balance to the 758 and 778 prefixes used by Mountain Bell. A 24% repression factor is a very high repression factor, and one of which this Commission is unconvinced on the basis of the record in this proceeding.

10. Allowance for Reimbursement of Attorneys' Fees and Expert Witness' Fees and Expenses.

From time to time since the Attorney General of the State of Colorado rendered Opinion No. 74-0035 on September 3, 1974, the Commission has allowed reimbursement of attorneys' fees and costs and expert witness fees and costs incurred in a rate proceeding, if the representation fell within the guidelines specified in Decision No. 85817, entered on October 15, 1974, in Investigation and Suspension Docket No. 867. The criteria set forth in said decision was slightly modified by the Commission in Decision No. 87701, on October 30, 1975, in Investigation and Suspension Docket No. 930. The criteria was recently restated to include the modification made in Decision No. 87701 in the Commission's Decision No. 91290, entered on September 13, 1977, in Case No. 5700. The revised criteria set forth in said decision is as follows:

> (1) The representation of the Protestant-Intervenor and expenses incurred must relate to general consumer interest and not to a specific rate or preferential treatment of a particular class of ratepayers; and
>
> (2) The testimony, evidence and exhibits introduced in the proceeding by the Protestant-Intervenor were exceptional and will materially assist the Commission in fulfilling its statutory duty to determine just and reasonable rates for the utility; and
>
> (3) The fees and costs incurred by the Protestant-Intervenor for which reimbursement is sought are reasonable charges for the services rendered on behalf of the general consumer interest.

To date of this decision, only Intervenor Colorado Municipal League has filed a motion requesting reimbursement of attorneys' fees and costs and expert witness' fees and costs. The Colorado Municipal League has requested reimbursement in the amount of $13,500 as representing one-half of incurred attorneys' fees and $2,169.22, as representing one-half of the costs advanced by said attorneys in this proceeding. Colorado Municipal League has further requested reimbursement of expert witness' fees and costs incurred in this proceeding. The League is

requesting reimbursement of $3,150 as the expert witness fee paid to Mr. Richard D. Gardner and costs of $831.43 incurred by Mr. Gardner. The League is further requesting reimbursement in the amount of $30,000 for the fee paid to Kosh & Associates, plus costs advanced on behalf of Mr. Kosh in the amount of $1,432.49. Based upon the criteria set forth above, the Commission finds that the participation of Intervenor Colorado Municipal League on behalf of general consumer interests materially assisted the Commission in fulfilling its statutory duty in this proceeding. Accordingly, the Commission will hereinafter order Mountain Bell to pay to Colorado Municipal League the sum of $44,216.22, consisting of the following:

(a)	Attorneys' fees	$10,615.00
(b)	Attorneys' costs	2,169.22
(c)	Expert witness fees:	
	Kosh & Associates	30,000.00
(d)	Expert witness costs:	
	Kosh & Associates	1,432.00

Said sum of $44,216.22 shall be booked by Mountain Bell as an operating expense, to be amortized, to be amortized over a period of two years.

Since this Commission first began allowing expert witnesses' fees and costs to intervenors, intervenors have been required to demonstrate to the Commission the "value" of the testimony under the guidelines quoted above. Mountain Bell should be required to do no less. Accordingly, in future general revenue requirement rate proceedings involving the Company, the Company, if it intends to claim the fees and costs of a noncompany expert witness as an item of operating expense for ratemaking purposes, shall demonstrate to the Commission that the noncompany expert witness testimony and exhibits fulfill the following criteria:

> (1) The Company does not employ a person in the Company as a whole who could have presented such testimony in the proceeding; and
>
> (2) It was more economical for the Company to have called as a witness such a noncompany expert, than to employ on a permanent or part-time basis a person with the training and experience necessary to have presented such testimony and exhibits; and

(3) The testimony and exhibits introduced in the proceeding by the noncompany expert witness were exceptional and will materially assist the Commission in fulfilling its statutory duty to determine just and reasonable rates for the Company; and

(4) The fees and costs incurred by the Company for the noncompany expert witness are reasonable charges for the services rendered on behalf of the Company.

11. Spread-of-the Rates.

The Commission in Phase II of this proceeding has decided to accept a number of the recommendations by Mountain Bell for restructuring of rates, resulting in minor increases or decreases. Specifically, the Commission has accepted Mountain Bell's proposal for restructuring Service Charges (including suspension and restoral of service charges), restructuring of Service Station Service charges, standardizing mileage charges for Four-Party Service, restructuring of mileage charges for Eight-Party Service. The Commission has also accepted Mountain Bell's proposal to increase basic residential Local Exchange Service from 6¢ to 10¢ per month, depending on rate group. The Company's proposals are set forth in the testimony of Mr. Robert T. Fuller (Exhibit U), filed in Phase II of this proceeding. The Commission has rejected all other proposals for either increasing or restructuring rates, as proposed by Mountain Bell in Phase II. In lieu thereof, the Commission has determined (1) to increase Intrastate Toll charges by $3,049,611. This total shall be generated by restructuring the Intrastate Toll charges to as close a parity as possible with the present interstate toll rates for Mountain Bell. Mountain Bell shall first increase operator-handled station-to-station and operator-handled person-to-person intrastate call rates. If said increases do not generate, on an annual basis, approximately $3,049,611, then Mountain Bell shall increase Intrastate Toll rates for Direct Distance Dialing to make up the balance. (2) The Commission has also determined to accept some repricing of the obsolete tariff rates for business terminal telephone

equipment, but not to the amount proposed. Mountain Bell shall file tariffs revising such rates so as to generate additional gross revenues of $3,049,611. Repricing of the obsolete tariff rates for business terminal telephone equipment shall be on an arithmetic repricing. Repricing on the basis of a Long Run Incremental Analysis model is specifically rejected. (3) Service Charges continue to be a matter of much concern. For the test year, costs associated with installation and removal exceeded revenues directly charged therefor by some $18.9 million. This translates into a revenue necessity of $40.3 million needed to offset deficient charges for installation and removal of service. In addition to the restructuring proposed by Mountain Bell to Service Charges, the Commission has determined to increase several of the services charges showing the largest deficiency between revenues and costs. Mountain Bell has proposed in this proceeding that a residential prewiring charge of $6.00 per outlet be ordered. The Commission has determined to increase the charge to $8.50 per outlet for prewiring to conform it with the proposed charge per outlet for residential post-wiring. Mountain Bell has proposed, with respect to Service Order charges for businesses for new or additional central office lines where field work is required, a charge of $26.00 and where field work is not required, a charge of $23.00. These charges should be revised so that the service ordering charge where field work is required will bear a charge of $35.00 and where field work is not required a charge of $32.00.

12. Expansion of 2MR and 1UR Service.

Mountain Plains Congress of Senior Organizations proposed in this proceeding that 2MR (Two-Party Measured) service be expanded to all central offices equipped with No. 1 or No. 2 ESS (Electronic Switching Systems). Mountain Bell has opposed the extension of 2MR service, and also 1UR (One-Party Usage Sensitive) service, beyond its present availability, but prefers that if either is to be expanded, that it be 1UR service. The Commission sees no valid reason why such low cost services should not be made available throughout the State to those customers served from central offices equipped with No. 1 or No. 2 ESS. If a customer

desires either low cost service, that customer should not be denied the opportunity to subscribe to said service. Mountain Bell has estimated that if 2MR and 1UR services were made available on a state-wide basis in those central offices equipped with No. 1 or No. 2 ESS, that for the calendar year 1978 it would suffer a revenue deficiency of $77,000 with respect to 2MR and $97,900 with respect to 1UR service. This would assume that 2% of the customers to whom this new service would be made available would subscribe, and that all 2% were subscribers for the full calendar year. Inasmuch as those customers who will be subscribing to said services will not all subscribe at the same time, and on January 1, 1978, for the calendar year 1978, Mountain Bell will not be suffering a revenue deficiency of $52.20 per customer who subscribes to 2MR service, nor suffer a revenue loss of $23.50 per customer subscribing to 1UR service. Inasmuch as it is impossible to predict how many and at what time customers will be subscribing to either 2MR or 1UR service, the Commission has made no allowance for revenue loss due to the expansion of either service.

Mountain Bell, as hereinafter will be ordered, shall file tariff revisions making 2MR and 1UR services available throughout the State to all customers served from central offices presently, and hereafter equipped, with No. 1 ESS or No. 2 ESS, or switching equipment with similar capabilities. The rates prescribed therefor shall be set at the same percentage of the 1FR (One-Party Residential) rate in those rate groups as the 2MR and 1UR rates presently are of the 1FR rate in the Denver Metropolitan area. The call allowance for all 2MR services shall be decreased to 50 calls per month, and the charge per call in excess of the 50-call allowance shall be increased to 10¢ per call. Mountain Bell is admonished to insure that the availability of 2MR and 1UR services are brought to the attention of all potential customers by a billing insert, and media advertising. Mountain Bell shall file with the Commission a copy of the billing insert and a copy of each type of advertisement. Accompanying such copies shall be a statement informing the Commission during what billing cycle or cycles the billing insert was mailed to potential

customers, in what news media (with date) the advertisement was placed, and the costs incurred. In addition, Mountain Bell shall instruct its employees that each time a new customer contacts Mountain Bell requesting service or an existing customer contacts Mountain Bell requesting a change in service, that such customers shall be informed orally of the availability of both 2MR and 1UR services.

CONCLUSIONS ON FINDINGS OF FACT

1. The Public Utilities Commission of the State of Colorado has jurisdiction over the Colorado intrastate telephone rates of Mountain Bell, and has jurisdiction over the subject matter of this proceeding.

2. The tariff rates that are presently in effect, in the aggregate, are not just, reasonable or adequate, and, based upon the test year ended December 31, 1976, result in a net operating deficiency, on a test-year basis, of $3,614,000. Therefore, an increase in revenue in the amount of $7,712,000 is required to offset the net operating earnings deficiency of $3,614,000.

3. Total revenue requirement, excluding interest charged construction and including uncollectible revenue, of Mountain Bell to be derived from its Colorado intrastate telephone operations on the basis of test-year conditions is $360,098,000.

4. The rates and charges as proposed by Mountain Bell in the tariffs accompanying Advice Letter No. 1279, would, under test-year conditions, produce a total annual revenue, including uncollectible revenue, of $399,776,000. To the extent that revenue produced by such rates and charges would exceed Mountain Bell's revenue requirement of $360,098,000, said rates and charges are not just and reasonable.

5. A fair and reasonable rate of return on average-year rate base for Mountain Bell's Colorado intrastate operations is 9.40%.

6. A fair and reasonable rate of return on average-year equity for Mountain Bell's Colorado intrastate operations is 11.5%.

7. The gross increase in revenue of $7,712,000 should be allocated as set forth in Finding of Fact No. 28.

An appropriate order will be entered.

O R D E R

THE COMMISSION ORDERS THAT:

1. The revenue requirement of Mountain States Telephone and Telegraph Company in this rate proceeding, including uncollectible revenues and excluding interest charged construction, for its Colorado intrastate telephone business, on the basis of the test-year 1976 conditions, is $360,098,000.

2. The difference between the required net operating earnings for Mountain States Telephone and Telegraph Company's Colorado intrastate telephone business for the test year, of $74,755,000 and the actual net operating earnings, as adjusted for the same period, of $71,141,000, results in an earnings deficiency of $3,614,000.

3. An increase in revenue in the amount of $7,712,000 is required to offset the $3,614,000 net operating earnings deficiency.

4. The rates and charges as proposed by Mountain States Telephone and Telegraph Company in Advice Letter No. 1279, under investigation herein, would, under the test-year conditions produce additional gross revenue not to exceed $50,588,000, or a total annual revenue (including uncollectible revenue) of $399,776,000.

5. To the extent the revenues produced by the rates and charges contained in the proposed revised tariff sheets filed with Advice Letter No. 1279 would exceed the $7,712,000 gross increase in revenue required to offset the net operating earnings deficiency and exceed the $360,098,000 total revenue requirement, such proposed rates and charges are not just and reasonable.

6. The tariffs filed with Advice Letter No. 1279 be, and hereby are, rejected.

7. Mountain States Telephone and Telegraph Company be, and hereby is, ordered to file new tariff revisions implementing Finding of Fact No. 28.

8. Mountain States Telephone and Telegraph Company be, and hereby is, ordered to file within thirty (30) days after the effective date of this Order tariff revisions implementing Finding of Fact No. 29. Mountain States Telephone and Telegraph Company be, and hereby is, ordered to inform all potential customers of the availability of 2MR and 1UR services by billing insert and media advertisements. Mountain States Telephone and Telegraph Company be, and hereby is, ordered to file with the Commission a copy of the billing insert and a copy of each type of advertisement. Accompanying such copies shall be a statement informing the Commission during what billing cycle or cycles the billing insert was mailed to potential customers, in what news media (with date) the advertisement was placed, and the costs incurred. In addition, Mountain States Telephone and Telegraph Company be, and hereby is, ordered to instruct its employees that each time a new customer contacts the Company requesting service or an existing customer contacts the Company requesting a change in service, that such customers shall be informed orally of the availability of both 2MR and 1UR services.

9. Mountain States Telephone and Telegraph Company be, and hereby is, ordered to pay Colorado Municipal League within thirty (30) days after the effective date of this Order, $44,216.22, as reimbursement of attorneys' fees and costs and expert witness' fees and costs incurred by the Colorado Municipal League in this proceeding. Such amount shall be amortized over a period of two years.

This Order shall be effective October 21, 1977.

DONE IN OPEN MEETING the 30th day of September, 1977.

(S E A L)

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

EDWIN R. LUNDBORG

EDYTHE S. MILLER

SANDERS G. ARNOLD

Commissioners

ATTEST: A TRUE COPY

Harry A. Galligan, Jr.